THE NAVY WILL HAVE LESS MONEY IN THE FUTURE, NOT MORE

Remarks on Naval Shipbuilding Plans before the Seapower & Expeditionary Forces Subcommittee of the House Armed Services Committee

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Thank you for the opportunity to be here today.

I would like to briefly review the military and economic challenges our nation faces, and then draw some conclusions about the outlook for naval ship construction.

The **security challenges** we face today are not worse than they were 20 years ago (what could be worse than having 10,000 nuclear warheads aimed at your country?) but they are more diverse.

Many of the challenges that trouble us today -- such as failed states, Islamic terrorism and nuclear proliferation -- barely affected our military plans at all during the cold war.

But that world is now long gone, replaced by a landscape of dangers that are both ambiguous and ubiquitous, thanks to the information revolution.

In this new world the joint force must be all things to all people, because we simply can't say how threats will shift from year to year.

The sea services now spend much of their time engaged in non-traditional missions, and those missions often must be carried out even farther from home than in the old days.

So changes in the character and location of the security challenges we face, by themselves, would be enough to warrant a rethink of what kind of navy we need.

However, that will not be the biggest concern we have in the decade ahead.

The biggest concern will be that our **economy is in decline** and the federal government is out of money.

How broke is the federal government?

-- So broke that during the two hours we are meeting this morning it will spend $400 million it does not have.

-- So broke that the federal debt has doubled to $11 trillion in just eight years, and threatens to double again in the next eight.

-- So broke that we are sustaining our defense posture in part by borrowing money from the same country our military planners are preparing to fight.

There is no time in living memory when U.S. finances have been in such bad shape, and therefore all the things we thought we knew about the future availability of funding for the joint force are suspect.

I have attached to the remarks I gave the subcommittee my cover story from the current issue of *Armed Forces Journal* about the impact of economic decline on military preparedness.

The article concludes that the days when 5% of the world's population (us) could sustain nearly 50% of the world's military spending are coming to an end.

What that means for **naval ship construction** is that current Navy plans are not affordable.

If we build the kind of networked, interoperable national fleet envisioned in the joint maritime strategy, then we can get very good results from the warships we do buy.

But we cannot get Navy ship numbers above 300 unless we purchase smaller, cheaper warships.

Unfortunately, that approach will not work with aircraft carriers or submarines, where we are locked into costs and construction rates that can only be cut by substantially reducing our global presence and warfighting capability.

We must sustain production of the *Ford* class of future **aircraft carriers** at the rate of one every four years, otherwise the number of flattops in the Fleet will remain below the twelve required.

And we must build the *Virginia* class of attack **submarines** at the rate of two per year for the foreseeable future if we are to avoid huge gaps in undersea warfare and intelligence-gathering capabilities.

Thus, the savings needed to bring naval ship construction into alignment with likely resources will have to be found mainly in surface combatants and vessels associated with amphibious warfare.

The Navy has already begun the necessary adjustments by proposing to cancel the **DDG-1000 destroyer,** which is too costly and ill-suited to the emerging threat environment.

Terminating production at three vessels -- and preferably two -- while continuing construction of versatile **Aegis destroyers** is the only sensible response to military and fiscal realities.

With regard to smaller surface combatants, the Navy needs to make a choice between the two versions of the **Littoral Combat Ship,** and consider supplementing LCS with the more conventional **National Security Cutter** being built for the Coast Guard.

It is much too early to call LCS a "failed program" -- the lead ship was delivered to the Fleet in half the usual time, and had a successful inspection -- but the warships will cost more than expected and there are uncertainties surrounding the concept of operations.

While the National Security Cutter is slower and requires deeper water to operate, it has similar on-board equipment and longer endurance, making it potentially applicable to numerous missions.

The **amphibious fleet** presents a bigger puzzle, because it appears the stated requirement for 33 warships is too small given the greater bulk of up-armored combat vehicles and the need to establish Global Fleet Stations.

The decision to use the LPD-17 hull as a replacement for aging LSD vessels is a step towards greater affordability, since it greatly reduces design costs and extends serial production of an existing ship-type.

However, there are real doubts about the affordability of the future maritime prepositioning force, a fact underscored by OMB's suggestion in its fiscal 2010 budget guidance to the Navy that spending on new prepositioning ships be canceled.

I would be pleased to elaborate on my views concerning all these programs during the question-and-answer period.

AMERICA'S ECONOMIC DECLINE: WHAT IT MEANS FOR NATIONAL DEFENSE

Cover Story, *Armed Forces Journal*, March 2009

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The United States has possessed the most powerful economy in the world for so long that no one alive today can remember a time when America was not Number One. The armed forces have been a big beneficiary of the nation's economic success. Although Pentagon planners frequently complain about having to operate in a "fiscally constrained" environment, the United States accounts for nearly half of global military outlays. It is a remarkable reflection of America's economic strength that less than five percent of the world's population can sustain such a high level of defense spending, using less than five percent of gross domestic product.

But what if America ceased to be the world's biggest creditor, its largest producer of goods, its most successful trader? Sad to say, those questions are no longer hypothetical. Over the last 30 years, the nation that practically invented free enterprise has become the world's biggest debtor, has witnessed the rapid decline of a manufacturing sector once dubbed the "arsenal of democracy," and has accumulated an annual trade deficit equivalent to well over $2,000 per citizen per year.

In other words, America's economy is in decline. The problem isn't just a severe cyclical downturn caused by excesses in the housing market. The economy is undergoing a more profound, secular erosion that has resulted in it giving up a little more of its share of global output every year in this decade, in much the same way that General Motors and Ford have gradually yielded share in the domestic automobile market. When the current decade began, America generated nearly a third of world output. By the time it ends, America will claim barely a quarter. Optimists such as Fareed Zakaria describe this trend as "the rise of the rest," but it might just as easily be called the decline of the West, especially America.

The negative economic news has not yet had much impact on the thinking of military analysts. They are accustomed to thinking of defense as one of the few sectors in the national economy driven by non-economic forces, namely threats and politics. But if the country's economy continues to weaken, it is inevitable that the resulting scarcity of funds will force reductions in military outlays. Furthermore, the decline of specific industrial sectors such as steelmaking, electronics, chemicals and pharmaceuticals will limit the options military planners have for sustaining the most demanding military campaigns. So policymakers need to take a hard look at what current economic trends mean for the nation's future military preparedness.

The place to start is by asking three basic questions. First, how serious is the decline in America's economic power? Second, what does the decline portend for the affordability of the planned defense program? And third, how can defense outlays be structured so that they help the economy rather than hurt it? Liberals and conservatives alike will question the wisdom of making defense spending decisions according to economic criteria, but as the following analysis

indicates, separation of the two spheres is no longer affordable because Washington is out of money.

How Serious Is The Decline?

Shortly before President Obama took office, the U.S. intelligence community's top analyst completed a major assessment of global trends through 2025. The analyst, Thomas Fingar, predicted that the international system would be "transformed" over the next 15 years in much the same way that it was remade after World War Two. But unlike during the cold war, when America rose to unrivaled supremacy, Fingar's study predicted it would be China that had the most influence on global politics and economics in the years ahead. The United States would probably remain the single most powerful nation in the near term, Fingar concluded, but in relative terms China would be rising fast and America would de declining.

Fingar traced the source of these trends mainly to America's loss of economic power. He said that, "In terms of size, speed and directional flow, the transfer of global wealth and economic power now under way -- roughly from West to East -- is without precedent in modern history." Shortly after Fingar's findings became public, former deputy treasury secretary Robert Altman rendered a similar verdict in *Foreign Affairs* keyed to the credit-market collapse. Altman warned that the unfolding financial crisis "is a major geopolitical setback for the United States and Europe," and predicted it would "accelerate trends that are shifting the world's center of gravity away from the United States." He too saw China as a rising power poised to capitalize on America's decline.

Such fears might be overstated in much the same way that warnings of Japan's rise were overdone a generation ago. Concern about national decline has been a commonplace topic among intellectuals since Edward Gibbon published the first volume of *The Decline and Fall of the Roman Empire* in 1776. Clearly, some of the more pessimistic predictions from past generations were wrong. Even today, there is much misinformation in the public media about precisely what's wrong with America. For example, as a recent RAND Corporation study pointed out, it is hard to argue that American science is in decline when the nation generates 40 percent of all research spending among industrialized countries, produces a similar share of patented innovations, and hosts three-quarters of the world's top 40 universities. In a typical year, IBM generates more technology patents than all of China combined.

However, America's scientific prowess is no longer translating into economic strength the way it once did. A review of economic trends over the past decade reveals rapid deterioration in the solvency and competitiveness of the U.S. economy.

Economic growth. The growth of the economy has lagged behind the rest of the world for a dozen years, averaging barely two percent annually during the Bush Administration. Between 2000 and 2008, the U.S. share of global output fell from 31 percent to 27 percent. While the United States endured twin recessions at the beginning and end of President Bush's tenure -- and anemic growth in between -- China's growth rate averaged about ten percent annually throughout the decade.

Family income. The modest expansion that followed the dot.com meltdown at the beginning of Bush's first term produced no income gain for average families, the first time that has ever happened. Median household income remained stuck at about $61,000 annually, even as the price of everything from housing to healthcare to energy went up. The CIA estimates that all of the gains in income in the United States since 1975 have gone to the upper 20 percent of households.

Job creation. The last eight years have witnessed the lowest rate of private-sector job creation on record since World War Two. Most of the gains in employment have occurred in government or in areas closely related to government spending, such as education and healthcare. Meanwhile, the manufacturing sector has lost an average of 50,000 jobs every month for eight straight years.

Trade balance. The nation's annual trade deficit has doubled from an already sizable $380 billion at the beginning of the decade to well over $700 billion today. While much of the increase is traceable to rising oil prices that have fallen in recent months, the nation is also running a deficit of over a billion dollars per day in manufactured goods. The imbalance has weakened the value of the dollar while leading to vast accumulations of U.S. currency in foreign hands.

Budget deficit. The debt of the federal government has nearly doubled from $5.7 trillion at the beginning of the decade to nearly $11 trillion today. The yearly balance of federal outlays and tax receipts, which was substantially in surplus when President Bush entered office, deteriorated to a $480 billion deficit in fiscal 2008, and is expected to exceed a trillion dollars in fiscal 2009. President Obama has warned of trillion-dollar deficits for years to come as a result of the current economic crisis.

Bad as these broad-based indicators sound, they do not capture the full extent of erosion in some parts of the economy relevant to military power. That is especially true of the manufacturing sector, which includes most of the so-called defense industrial base. While aerospace companies are doing reasonably well, the overall health of U.S. manufacturing has been weakening for decades. The near collapse of the domestically-owned auto industry is just the latest indication of decline. Commercial shipbuilding and consumer electronics industries have largely disappeared since the 1980s, while U.S. steel-makers now account for only seven percent of global output (compared to 38 percent for Chinese steel-makers). Furthermore, the migration of manufacturing overseas is not confined to traditional metal-bending activities: the pharmaceutical industry is now incapable of manufacturing antibiotics like penicillin without supplies from China.

Will the Defense Plan Be Affordable?

In fiscal 2008, defense spending broadly defined claimed about five percent of gross domestic product and 23 percent of the federal budget. In addition to the baseline defense budget of $479 billion, $188 billion was spent on military operations in Iraq and Afghanistan, and $22 billion was spent on related activities outside the defense department, most notably the energy department's nuclear weapons program. The resulting total -- $689 billion -- is widely viewed as

the peak level of military outlays in the current decade since spending in the baseline budget is programmed to stabilize in subsequent years and expenditures on overseas operations are expected to fall.

Although it is too early to calculate the claim that defense spending will make on the economy in 2009 given the ongoing contraction of commercial markets, military spending of all kinds is likely to total about $670 billion for the year -- representing roughly twice the buying power of the Pentagon budget when the decade began. Proponents of robust military spending frequently argue that a defense commitment of that magnitude should be easily sustainable within a $14 trillion economy, especially given the likely decline in outlays for overseas operations. According to the Congressional Budget Office (CBO), if current plans for the baseline budget remain on track, regular military spending would drop to 3.1 percent of gross domestic product in 2013 and 2.5 percent in 2026. The latter figure is well below the lowest level of economic commitment made to military activities during the Clinton years, now remembered as a period of depressed defense spending.

So it is not hard to see why defense analysts haven't spent much time thinking about the affordability of the current defense plan. However, all of the projections of future military spending assume that the U.S. economy will continue growing at close to the historical average of about three percent annually. If that growth were to cease or reverse for a prolonged period of time, the resulting tensions within the federal budget would preclude steady funding of military activities unless there were a surge in threats. The most recent CBO estimate of the federal budget projects that in fiscal 2009, the government will spend the equivalent of 25 percent of gross domestic product while taking in 17 percent, resulting in the need to borrow over a trillion dollars. A deficit of that scale is not sustainable over the long run, and even in the short run depends on the willingness of overseas lenders -- who have bought four-fifths of Treasury debt in recent years -- to continue lending despite weakness in their own economies.

Beyond the parlous state of federal finances, there other reasons to doubt the affordability of the present defense plan. For example, CBO estimates that once unbudgeted costs are included in defense totals, military outlays will average $652 billion annually in constant 2009 dollars over the next 18 years. That is barely any decrease at all from the peak level of funding seen in the current decade when overseas contingencies and ancillary items are included. Yet the peak level of funding in this decade is well above the top end of the spending range seen over the previous 50 years, so it probably isn't sustainable given the many other obligations the federal government has taken on in that time.

If federal debt payments -- now over a billion dollars daily -- and entitlement programs weren't growing rapidly, the current level of military outlays might be sustainable in normal economic circumstances. But once the reality of a declining economy is combined with unfunded entitlement obligations of $43 trillion, the funding of defense needs looks doubtful. Entitlement programs are treated as formula-driven "mandatory" obligations within the federal budget, which means they are structurally and politically harder to restrain than the "discretionary" outlays in the defense budget. And even within the discretionary categories of federal outlays (about 45 percent of the total budget), defense must compete with such politically popular activities as the environment, education, criminal justice and general science.

As if all this were not enough, the parts of the defense program that are politically easiest to cut -- the investment accounts -- are the parts that contribute most tangibly to long-term military power. If military pay and benefits are slashed, the consequences are felt quickly in the field and on Capitol Hill. The same is true if readiness accounts are cut. With military healthcare costs having risen 144 percent during the present decade, there are compelling reasons to try to restrain their further growth (one Pentagon panel called cost increases in military healthcare an "existential threat" to the future defense posture). But investment in the future is almost always easier to cut than current consumption, because the near-term consequences in the field are imperceptible, and the domestic impact is felt in only a handful of congressional districts.

The bottom line, then, is that the current defense program will probably not be sustainable if the decline of the economy continues, and when the cutting begins to bring military outlays into closer alignment with available resources, the first items to go will be those that contribute most to the nation's long-term military power. In other words, the erosion of national economic power will be paced by the erosion of national military power.

Can Defense Spending Help The Economy?

Military spending traditionally has been viewed as a drain on the economy, which was one reason the government seldom spent more than one percent of gross domestic product on defense in peacetime prior to 1950. That pattern changed during the cold war, when sustained high levels of military expenditure made the "military-industrial complex" a seemingly permanent fixture on the economic landscape. Weapons research during that period is now widely credited with boosting the development of key industries such as computers and semiconductors. When the cold war ended, though, the Clinton Administration slashed military research. The Bush Administration restored funding without giving serious consideration to the connection between defense spending and economic growth.

Today, the connection needs to be examined more closely because the economy is in decline and the government is running out of money. Policymakers no longer have the luxury of spending a fifth of the federal budget on national defense without considering how those expenditures might help or hurt the economy. Relatively little research has been done on the subject, and much of it is tendentious. But even a cursory review of the data suggests that military activities have both positive and negative economic consequences. For example, the exceedingly complex weapons acquisition system probably harms the competitiveness of military suppliers by impeding efficiency; on the other hand, weapons development also sustains hundreds of thousands of scientists and engineers who potentially contribute to the nation's economic growth. Similarly, military recruiting activities may bid up the price of scarce labor by offering pay and benefits superior to what private-sector employers can afford, but the military also provides millions of personnel with training that proves useful when they return to the mainstream economy.

So military spending has mixed economic results, some of them positive and some of them negative. It is not a good way of quickly stimulating the economy because its effects are indirect, and money appropriated for weapons typically takes years to be spent. But compared with other ways of putting money into the hands of consumers, it definitely has some desirable

effects. For instance, much of the money taxpayers receive as a result of tax cuts may end up being spent on consumer durables from overseas such as automobiles, producing little net stimulus to the economy, whereas the vast preponderance of military outlays are spent in America on domestic goods and services. It may not make much sense to buy weapons simply to stimulate economic activity, but if there is a valid military requirement for equipment, then the case for its purchase is bolstered by its additional economic benefits.

Looking beyond the immediate economic crisis spawned by speculative activity in the housing market, the way in which military budgets are allocated may have an important impact on the more profound, secular decline that the economy is facing, which is largely traceable to the erosion of the manufacturing base. If system specifications are modified to minimize military-unique features and barriers to merging military workloads with commercial workloads are dismantled, then the economic benefits of defense investment outlays can be increased even though weapons outlays are falling. There would also be real economic advantages to thinking through where defense research and procurement funding is concentrated, both in terms of localities and technologies. These issues need to be considered much more rigorously today than in the past, because America's future as a global economic and military power can no longer be taken for granted.

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